The Impact of Interest Rate Caps on the US Credit Card Market

Executive Summary

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This white paper discusses the economic implications and evidence base on the effects of a proposed nationwide maximum of 10% on credit card interest rates, as supported by the Trump administration in early 2026 and as outlined in the "10 Percent Credit Card Interest Rate Cap Act" (S.381), hereafter The Act. Such caps entail price controls on a highly competitive US credit card market, and therefore will have the standard effects of lowering volume if imposed. We examine the evidence on how rate ceilings such as proposed in the Act interact with risk-based pricing, lender behavior, and consumer access to credit. The evidence base indicates that interest rate caps distort credit markets by preventing competitive lenders from pricing for risk. A large survey covering about 75% of the U.S. credit card market in January 2026 supports large volume reductions, indicating that 74% to 85% of open credit card accounts would be closed or have their credit lines drastically reduced. Our review of the international and national experiences with credit card caps reinforces that large volume reductions for high-risk populations would take place. Our analysis suggests that the overall impact of caps is to reduce credit availability for higher-risk and marginal borrowers, weaken credit inclusion, and generate downstream economic effects—such as reduced household consumption, heightened financial stress, and constraints on entrepreneurship and small-business formation.

Section 1: Introduction

In competitive markets, price competition leads to average cost pricing with normal margins and rates of returns on capital. For the US competitive credit card market, this implies interest rates will reflect servicing costs and default and delinquency rates among borrowers with risker borrowers being charged more than safer ones. Consequently, price controls such interest rate caps proposed by The Act will limit credit availability of high-risk borrowers the most. As always with price controls, supply will be curtailed and market volume reduced, in this case of high-risk credit.

This paper includes a policy and regulatory review of the rate caps, the impact they have across consumer credit products, borrowers, as well as their broader macroeconomic implications.

Existing evidence suggests that the Act would trigger a massive contraction in credit availability and reductions in credit card rewards programs along with increases in credit card fees. A large survey covering about 75% of the U.S. credit card market in January 2026 indicates that 74% to 85% of open credit card accounts would be closed or have their credit lines drastically reduced, affecting between 137 million and 159 million cardholders. We believe these estimates to be conservative given the evidence on the effects of previous legislation, the Durbin amendment, on the debit card market.

We predict the adverse impact on cardholders is worst among those with lower credit ratings (universally affecting sub-prime borrowers and below), as the inability to cover their lending costs with banned interest rates would be impossible. However, as much as 71% to 84% of prime borrowers would also lose access to credit cards altogether or at least have their lines of credit greatly reduced, and super-prime borrowers with the highest credit ratings would also be affected by a 10% interest rate cap or even a 15% interest rate cap. Raising the cap to 20% still adversely affects a large majority of borrowers, approximately 70% to 75%, or roughly 129 million to 140 million cardholders. Empirical evidence from both domestic and overseas examples of interest rate caps consistently shows reduced credit access for higher-risk and lower-income borrowers, increased reliance on costlier alternatives, and broader economic harms including reduced efficiency in credit markets and reduced consumer spending.

The paper is outlined as follows. Section 2 documents the existing evidence on the competitive nature of the US credit card market and its importance to overall US consumption activity. Section 3 examines the factors that contribute to credit card interest rates and explains that default risk is the primary source of interest rate differentials between accounts. Section 4 explains how credit cards provide a valuable form of financing and consumption smoothing for many households, especially lower-

and middle-income groups. Section 5 details 10 examples of interest rate caps and their negative effects, and Section 6 offers concluding remarks.

Section 2; The Competitive US Credit Card Market

Section 2.1: The Competitive Credit Card market in the US

Empirical evidence suggests credit cards are a highly competitive market, but a 2025 study published by Vanderbilt Policy Accelerator asserts without evidence that credit card markets are noncompetitive and that interest rate ceilings below market interest rates would only reduce bank profits without adversely affecting credit card customers. However, when analyzing market share of balances, the credit card market has a Herfindahl-Hirschman Index (HHI) of about 1,010 and the HHI falls to just 950 if credit cards issued by credit unions are included, as opposed to just credit cards issued by commercial banks. Even within the sub-prime market, where concentration is highest, the credit card market has an HHI of about 1,000 to 1,400. Index readings below 1,800 are considered unconcentrated, while values from 1,800 to 2,500 are considered moderately concentrated, and values above 2,500 are considered highly concentrated. In a pure monopoly, the HHI has a value of 10,000 and in a perfectly competitive market, the index asymptotically approaches zero. Thus, judging by the guidelines used by the Department of Justice and the Federal Trade Commission, credit card markets are competitive, contrary to the assertion in the Vanderbilt Policy Accelerator study.

Additionally, the study itself also notes aspects of the credit card market which indicate a high level of competition, not concentration, negating the assertion that these markets are noncompetitive. For example, the study notes that banks with credit cards spend on marketing 10 times the amount spent by banks that do not offer credit cards. It specifically noted that in 2023 Capital One spent $4 billion, roughly the same as Nike, on marketing while American Express spent $5.2 billion, more than Coca Cola. These are double the marketing budgets of larger lenders that are not major credit card banks.

Additionally, the study points to profits and charge-offs (from excessive loan nonperformance) as evidence of economic profit and therefore a noncompetitive market. There is a significant bias, however, in the period covered by the study. It examines accounts opened in 2015 through 2017 and observes their performance for six years. This period coincides with abnormally low charge-off rates and abnormally high loan performance because of the timing of the business cycle and the use of transfer payments in 2020 and 2021 which were used to pay down outstanding credit card balances. In other words, during the period covered by the study, people were more

likely than usual to repay what they borrowed and relatively few accounts were sold to collection agencies for pennies on the dollar, thus reducing losses and increasing profitability. However, if the study observed accounts that were opened just before the Great Recession, only a few years earlier than the period observed in the study, then charge-off rates would have been more than twice as high and profitability would have been significantly lower. The study fails to account for the fact that profitability must be considered by a credit card company over the lifetime of a line of credit, not merely for a few years. Thus, there is a bias in the study's results because it fails to make observations over the entirety of a business cycle, in this case excluding the least profitable period for credit card issuers.

2.2 The Importance of Credit Cards for Overall Consumption

Credit cards are used to purchase fully one-third of personal consumption expenditures, amounting to about 22% of overall gross domestic product. Credit cards were a lifeline for consumers after 2021 when inflation reached forty-year highs and far outpaced wage growth. The share of gross domestic product paid for with credit cards increased by about six percentage points from 2015 to 2022 as many Americans had no alternative to the liquidity afforded them by credit cards. During this period, the total number of transactions increased from 31 billion to 55.3 billion, while the price of those transactions increased from $2.8 trillion to $5.4 trillion, almost doubling. Despite the sharp rise in credit card usage and because of the recent rise in personal income, credit card balances as a share of income today are not higher than pre-pandemic levels. Additionally, the percentage of card holders paying their monthly balance in full today is higher than pre-pandemic rates.

Credit cards provide customers with liquidity and facilitate consumption smoothing over time. This is an especially valuable service today when about 37% of Americans would financially struggle with a $400 emergency expense, lacking cash or savings, and 40% of those without sufficient cash on hand would rely on a credit card to cover the expense. As further evidence for tight liquidity constraints among consumers today, 401(k) hardship withdrawals in 2025 set a record at about three times the rate seen before the 2020 pandemic. This means Americans are effectively using a retirement vehicle as a source of credit instead of using a more traditional source, like a credit card. Alternative sources of credit like hardship withdrawals tend to be more expensive methods of financing, given that hardship withdrawals require not only paying income tax on the amount withdrawn but also a penalty if the account holder is younger than 59 and a half years old. Further evidence of the importance of credit cards for consumption smoothing is found in credit limit increases. When credit card issuers are prevented from

increasing card holders' credit limits, households that use credit cards for income smoothing experience a modest but statistically significant welfare loss, meaning they are worse off than before. This effect is observed both when card issuers are prohibited from automatically raising credit limits (such as when card holders' income or credit score increases) and when card holders are prohibited from requesting a credit limit increase (such as when card holders anticipate a large upcoming expense).

Section 3: The Composition of Credit Card Interest Rates

There are four primary components, or contributing factors, for interest rates on credit card accounts: cost of funds, overheads, non-performing loans, and profit. The cost of funds is the expense credit card companies pay to borrow the money lent out on credit cards. When credit cards are issued by commercial banks, this cost of funds is typically the interest paid on demand deposits and time deposits. Overheads include the three broad categories of outreach costs, processing costs, and general overheads. Outreach costs include marketing, developing new products and services, network expansion, etc. Processing costs include the expenses of transferring funds and assessing default risk of borrowers, including attempts to overcome asymmetric information. General overheads include the business expenses not unique to credit card companies, such as general administrative costs. Non-performing loans impose costs from attempts to make accounts current and from the sale of delinquent debt to collection agencies, since the debt is sold for less than 10 cents on the dollar, representing a loss of more than 90% on that unsecured debt. In addition to covering all these expenses, the interest collected on loans must also provide for a profit.

Given the highly competitive nature of the credit card market and its relatively low concentration, economists typically assume economic profits (as distinguished from accounting profits) are near zero and that demand for credit is relatively price elastic. Evidence suggests that the return on credit card assets[1] is less than 2% and net credit margin[2] is less than 3%. Interest income accounts for about 80% of credit card companies' profitability. Given that the 10% cap as outlined in the Act would be a reduction of more than 50% from the current average interest rate, this would reduce profitability on most credit card accounts below zero. Assessing which accounts would still be profitable requires understanding how the three primary cost categories (the four

[1] The return on credit card assets is calculated as the sum of interest and noninterest incomes collected from credit card holders minus interest and noninterest expense and loan loss provisions, divided by average credit card balances.
[2] The net credit margin for credit cards is interest income minus collections expense and the share of interest and noninterest expense attributable to revolving balances divided by revolving balances.

categories outlined above excluding profit) differ from one account to another. The cost of funds and overheads are essentially the same across borrowers with only the cost of non-performing loans differing between accounts. In other words, default risk is the marginal factor in setting interest rates on credit card accounts and is the primary reason for the interest rate differential between high- and low-risk borrowers. Due to the large losses suffered in charge-offs, there is a high-risk premium for lending to borrowers who are more likely to default. This relationship is still observed after controlling for business cycle timing, size of loans, size of banks, and geographical region. As discussed in Section 4, the borrowers most impacted by a 10% rate cap as proposed in the Act would be riskier borrowers, or those with lower credit scores, but even super-prime borrowers would be negatively affected.

Section 4: The Role and Value of Credit Cards to High-Risk Borrowers

Credit cards play a disproportionately important role for the roughly one-third of U.S. adults with sub-prime or near-prime credit scores, populations that are often low- or moderate-income, younger, or rebuilding after financial setbacks. For these households, mainstream credit options are scarce, making credit cards one of the few regulated, scalable sources of liquidity, credit-building opportunity, and financial shock absorption. Credit cards are the most common tool for these households when attempting to smooth consumption over time with about 80% of Americans having access to credit cards and more than 500 million credit card accounts open nationwide.

Responsible credit card use is one of the most effective ways for sub-prime and near-prime borrowers to build or rebuild credit history. Payment history accounts for 35% of FICO scores, and revolving accounts like credit cards provide ongoing, reportable activity across all three major bureaus. PYMNTS research (2025) found that 57% of subprime borrowers have access to credit cards, and 21% deliberately use them for essential purchases specifically to demonstrate repayment discipline and raise their scores. Sub-prime consumers are 30% more likely than higher-score borrowers to add purchases and pay them down with the explicit goal of score improvement. Specialized products like secured cards (e.g., Capital One Platinum Secured, Discover it Secured) and sub-prime unsecured cards routinely report positive payment data. Industry promotions and studies show average score increases of 47–71 points within six months for users who make on-time payments and keep utilization low. The CFPB's earlier work on credit-builder products similarly found that access to reportable revolving credit significantly raises the likelihood of having a scorable file (by 24% for those without prior loans) and can lift scores by 60+ points for those starting with no debt. For many with thin,

damaged, or no credit files, a credit card is the first regulated product that appears on their report, opening doors to auto loans, mortgages, and better insurance rates over time.

Low- and moderate-credit-score households are more likely to face income volatility, limited savings, and higher exposure to financial shocks. The Federal Reserve's 2024 Survey of Household Economics and Decision-making (SHED) found that 37% of all adults could not cover a $400 emergency expense using cash or savings alone. Among those unable to pay fully with cash-equivalent, 15% said they would put the expense on a credit card and carry a balance. Lower-income and lower-credit households are overrepresented in this group and rely more heavily on revolving credit to bridge gaps or cover large, unplanned expenses. Empirical studies confirm the consumption-smoothing role of revolving credit for vulnerable populations and even for middle-class households. During periods of distress (e.g., unemployment, surprise medical bills, or extreme weather events), access to credit cards helps maintain spending on essentials such as food, housing, and repairs. Without this buffer, households cut nondurable spending sharply. Credit cards also provide fraud and purchase protections that are often unavailable with cash, payday loans, or informal borrowing. Purchase protections can be very important safeguards for those with fewer resources to absorb losses.

4.1 The Costlier Alternatives to Credit Cards for High-Risk Borrowers

Even at elevated subprime interest rates (typically 25–35%), credit cards remain far cheaper than payday loans or similar services (averaging about 400% APR) and offer structured repayment, grace periods, and consumer protections under the CARD Act and Truth in Lending Act. For households that already have cards, they frequently serve as a preferable, lower-cost buffer compared with payday or title loans. While substitution patterns are complex and much depends on the individual borrower's discipline, the presence of a credit card usually reduces reliance on the most expensive alternative-financial-services products. In short, for low- and moderate-credit-score Americans, credit cards are not a luxury but a critical tool for financial mobility, resilience, and inclusion. They enable credit building that leads to better future terms, provide regulated liquidity during volatile periods, and help avoid even costlier or unregulated alternatives. Any policy, such as the Act, that sharply restricts access to these products would disproportionately harm the very households that depend on them most. In addition to losing access to credit, customers would also lose rewards programs like cash back, airline miles, and more. Even if a card holder with a super-prime credit score retains access to credit, the associated rewards program likely will be reduced or eliminated as happened with debit cards after the Durbin amendment. Sub-prime or

even near-prime borrowers would likely lose any credit card rewards altogether under caps of 10%, 15%, or even 20%.

While the primary benefits of debit cards before the Durbin amendment were services like rewards programs as well as free noninterest checking accounts with no or low minimum balances, the primary benefit of credit cards is liquidity, though many offer some kind of cashback or similar reward. Unlike a debit card which draws funds immediately from the card holder's bank account, a credit card is a line of credit with balances owed not coming due until sometime (often up to a month) after the statement period closes. Limiting interchange fees on debit cards, the primary source of revenue from those cards, caused a significant reduction in the primary benefit that was funded by those fees, and limiting credit card interest rates would similarly cause a significant reduction in the primary benefit (credit access) that is funded by credit card interest payments.

After the Durbin amendment, interchange fees per transaction fell approximately 45%, from about 44 cents to about 24 cents. One Federal Reserve study estimated that the regulation caused the share of free basic checking accounts to fall approximately 54%, from about 61% to 28%. Even when including exempted banks in the analysis, there was still a 47% decline. The impact on debit card rewards was even more pronounced. After the Durbin amendment, issuers of 81% of debit cards impacted by the change ended debit card rewards programs going forward. Additionally, banks issuing debit cards turned to new or heightened checking and banking fees to recoup billions of dollars in lost debit card transaction fees after the Durbin amendment. While data is not available on the total percentage of debit card users who experience some adverse impact because of the Durbin amendment, this percentage would be no smaller than 81%, even if all the other negative changes (like higher fees) occurred only within the same group that also lost their rewards programs. However, since some banks kept modest rewards programs but also added additional fees to checking accounts, it is safe to assume the percentage of debit card holders negatively effected was higher than 81%.

The average interest rate on commercial bank credit cards that charge interest is 22.30% at the time of this writing. This is less than the average of 31.3% on private label (store) cards. Instituting a 10% interest rate cap on credit cards as outlined in the Act would represent a reduction of approximately 12.3 percentage points or 55% from the average rate on those cards, an even larger decline than the reduction in interchange fees per transaction that resulted from the Durbin amendment. A 2026 ABA study estimated that between 74% and 85% of credit card customers would be adversely impacted (accounts closed or credit lines drastically reduced) by a 10% interest rate cap. Given that the 45%

reduction in interchange fees following the Durbin amendment caused a significant adverse impact on at least 81% of accounts (and likely nearly all accounts), and given that imposing a ceiling on credit card interest rates of 10% would be a reduction of 55% from the current average interest rate, the percentage of credit card accounts adversely impacted by such a rate cap would likely be more than 81%, either near or above the upper limit of the range in the ABA report. We therefore consider the estimated impact outlined in that study to be conservative. Additionally, the average interest rate on credit cards is even above 10% for card holders with super-prime credit, meaning the interest rate cap would affect every quintile in the credit card rating range from deep sub-prime to super-prime. Once again, the adverse impact of losing access to credit is greater as credit scores decline, including with a cap of 15% or 20%, though the impact on super-prime borrowers is less with a 15% cap and still more so if the cap is set at 20% since this cohort has an average effective interest rate of about 13% to 18% on existing accounts and 17% to 21% on new accounts.

Payday loans have an average annual percentage rate of 400%, more than 18 times the average rate on credit cards. While a 10% cap would affect nearly all prime and even many super-prime borrowers, it would affect all sub-prime borrowers since their average interest rate on credit cards is over three times the Act's proposed 10% cap. More than three-quarters of those who use payday or similar loans have sub-prime or deep sub-prime credit scores and repeated denials from mainstream lenders over the last 12 months, often indicating they were turned down for new credit cards. Without access to any credit cards at all, sub-prime borrowers would have to resort to payday loans. Federal Reserve research, including the regional banks of Boston, New York, and Philadelphia, from 2025 indicate elasticities are quite high regarding the impact of higher interest rates on borrowing and spending. Elasticities are highest among sub-prime borrowers, consistent with their greater liquidity constraints. In the long run, the loss of access to credit cards will make borrowing prohibitively expensive for sub-prime borrowers whose only other option for borrowing would be payday or similar loans. For this cohort, their borrowing falls to zero in the long run. As a robustness check for these findings, when transactors, or those who pay in full each month so that they do not carry a balance and therefore never pay interest, are faced with higher interest rates, their elasticity is near zero, meaning they show little to no response to changes in interest rates. (Transactors are also most likely to be super-prime borrowers.) While sub-prime borrowers' spending will decrease in the long run, it does not immediately fall to the point where borrowing is eliminated. The short-run impact on sub-prime borrowers would be higher interest payments. These effects would be the same for this cohort with lower credit scores if the interest rate cap were 15% or even 20%. Some may assert the

paternalistic view that reduced borrowing to zero among households with poor credit is a positive for those households because it eliminates any interest expense for them as well as the possibility that those people will misuse any credit extended to them. However, restricting access to credit has repeatedly been shown to cause deterioration in households' overall financial conditions.

Section 5: Lessons from Previously Attempted Price Controls on Credit

This section discusses the adverse experiences of previous attempts to cap interest rates internationally and nationally.

5.1 Lessons from Arizona

In 2008, voters rejected Arizona Proposition 200 (Payday Lending Reform Act), effectively sunsetting payday lending authorization in the state and causing hundreds of loan stores to close. Consequently, the state lost a net $300,000 in licensing fees. Former payday lenders shifted to offering other, more expensive lending options. This included auto title loans and the number of locations offering this particular loan product rose from about 160 when the proposition appeared on the ballot to more than 630 just seven years later, exceeding the number of locations that previously offered payday loan products. While many high-risk borrowers were still able to access credit if they owned a vehicle, the cost of credit increased. For high-risk borrowers who did not own a vehicle, however, credit access was much more limited, causing borrowers to seek out still more expensive credit options, such as lenders who had partnered with Native American tribes to evade rate caps.

5.2 Lessons from Arkansas

Unlike other states, Arkansas is unique in that it has interest rate caps in its constitution. Prior to being overridden by federal law in 1999, it had a constitutional 10% cap. In 2011, a constitutional amendment set the cap at 17%. As a result of these caps, traditional small-dollar installment lenders simply do not operate in Arkansas because it is unprofitable to do so. There are effectively no payday lenders in the state, producing a strong border effect. Residents living in counties bordering other states are much more likely to travel to those other states and access credit there, as compared to residents living in counties near the middle of Arkansas. This has created what is sometimes known as a credit desert throughout the interior of the state, where higher-risk borrowers have no access to any form of legally sanctioned credit. In addition to reducing access to credit, the cap has produced two other effects. When Arkansas residents must drive to neighboring states for credit, they incur an additional expense,

which significantly increases the total cost of borrowing. Including travel costs, these borrowers effectively have an APR of about 93%. The other effect is higher retail prices for products like appliances when compared to neighboring states. This occurs because retailers raise prices in order to offset lower interest rates and thus maintain total interest paid on a given purchase.

5.3 Lessons from Chile

In 2013, the maximum legal interest rate was set at 53.9% and in 2015 was decreased to 36.9%. Demand for credit among high-risk borrowers surged but the lower ceiling on interest rates created a shortage. Just six months after the 36.9% rate was imposed, the 10% of households lost access to credit, with the impact being greatest on younger, less educated Chileans and lower-income households. Although consumer spending also declined after the reduction in the maximum interest rate, it's unclear whether this particular effect was attributable to the new law. It's worth noting that the change from 53.9% to 36.9% was a decline of about 32% which is not nearly as large as the 55% reduction from the current average interest rate in the U.S. to the Act's proposed 10% cap.

5.4 Lessons from Illinois

In 2021, Illinois imposed an all-in rate cap of 36% APR, which included non-credit charges and not just the interest charged on outstanding balances. After the cap was imposed, sub-prime borrowers experienced significant difficulty in finding credit. The number of loans to sub-prime borrowers declined by 36% to 44% and the number of loans to deep sub-prime borrowers declined by 57% in just six months. Survey responses for Illinois and neighboring Missouri, which did not impose a rate cap, indicated that Illinoisans were significantly worse off because of the law, with 39% of survey respondents reporting a decline in their financial wellbeing while. Those who lost access to credit reported difficulty paying bills on time, increased late fees and penalties, skipping urgent medical care, and delaying much-needed household purchases as more than half of survey respondents said they were unable to borrow necessary funds. Nearly four-in-five (79%) Illinoisians who lost access to credit reported that they wanted the option to return to their previous lending arrangement, even at the old, higher cost of borrowing.

5.5 Lessons from Kenya

After constitutional reforms in 2010, Kenya instituted interest rate caps that were linked to central bank rates. Consumer credit shortages quickly ensued. Loans outside of the normal banking process then increased 53% while banks shortened the term of the

average loan significantly to mitigate risk, giving borrowers less flexibility and making repayment impossible for borrowers who needed to stretch out repayment over longer terms. Commercial banks increased lending to low-risk corporate clients and stopped lending to many higher-risk small borrowers and those seeking unsecured loans. These latter groups were forced to seek credit in unregulated markets within Kenya, where the cost of borrowing was higher.

5.6 Lessons from New Jersey in the 1930's

The phenomenon of shortages resulting from setting a price ceiling beneath the equilibrium price in the loanable funds market is nothing new. During the Great Depression, lawmakers attempted to rein in what they considered predatory lending by implementing interest rate caps on small loan brokers in New Jersey. Data on brokers and banks show this policy implementation resulted in a sharp reduction in small loans. Consumers lacked alternative credit sources and were therefore shut out of the loanable funds market while brokerages went out of business. Consequently, market concentration for credit rose as the number of competing creditors declined.

5.7 Lessons from Oregon

In 2007, there were more payday loan outlets with 400% APR credit options in Oregon than McDonalds and Starbucks combined. That year, the state set a maximum APR of 150% and access to payday loans declined significantly. Former payday loan borrowers shifted to "incomplete and plausibly inferior scenarios" including knowingly incurring checking account overdraft charges or late fees on bills. Relative to residents in neighboring Washington which did not have a 150% APR cap, residents in Oregon reported their current financial situation deteriorating and expectations about future financial conditions also declined. One survey that measured any adverse financial outcome, including things like becoming unemployed, becoming homeless, a decline in current financial conditions, etc. found an increase of 25% in Oregon but a decline of 16% in Washington. Far from helping Oregon residents, the APR cap restricted access to credit among those who had no alternative credit available, thereby "hindering productive consumption smoothing and/or investment, e.g., in job retention."

5.8 Lessons from Rhode Island

Interest rate caps do not always reduce access to credit but sometimes instead reduce the quality of loan products available to borrowers (similar to the effects observed after the rejection of Arizona Proposition 200). Rhode Island reduced its payday loan interest rate cap from approximately 390% APR to 260% APR in 2010. From 2009, prior to the rate cap, to 2013, loan volumes did not decrease but loan structures changed, causing

fewer borrowers to pay off their loans, rolling them over instead. Those using payday loans became more likely to fall into a debt trap, and defaults increased. This dynamic mirrors the research findings in "Equilibrium Responses to Price Controls: A Supply-Chain Approach." A price ceiling below the equilibrium price does not always result in a reduction in quantity; there can also be a reduction in quality, or both quantity and quality.

5.9 Lessons from South Dakota

In 2016, voters approved a ballot initiative that imposed a 36% APR cap on short-term loans. Payday lending completely disappeared in the state and no new small-dollar credit options emerged to replace this source of credit. This has left many former borrowers with no access to credit, and the number of open accounts fell 20% since these higher-risk borrowers were unable to switch to banks or credit unions. Conversely, those with prime credit scores experienced greater access to credit as lenders redirected funds to accounts that were still profitable at the 36% cap. For households with lower credit scores who lost access to credit, there was no improvement in delinquency rates.

5.10 Lessons from the United Kingdom

In addition to an interest rate cap on short-term loans, the United Kingdom also instituted maximums for total interest on the life of the loan as well as default fees, per the final rule published by that government in 2014 and implemented in 2015. These measures resulted in major lenders leaving the market entirely while those lenders that remained greatly increased their lending standards, immediately excluding 70,000 then-current borrowers from the short-term credit market. In the first five months alone after the regulation was implemented, the number of short-term loans and total amount being borrowed fell more than one-third, by about 35%, as many low-income households lost access to credit. The harmful effects on borrowers were similar to other cases where consumption smoothing was more limited among low- and even middle-income households.

Section 6: Concluding Remarks

While advocates for anti-usury policies assert that interest rate caps like those in the Act will benefit consumers, especially lower-income households, the reality is exactly the opposite. Those most harmed by such price ceilings are consumers who rely on credit cards as a financial lifeline to cover unforeseen expenses like a medical bill or car repair. Even Americans with average credit scores would lose access to credit cards, causing a dramatic change in consumer behavior. Not only would this push many borrowers into

more expensive sources of credit, but it would cut off others entirely from any legitimate credit access at all. The result of this liquidity constraint would be a significant and negative impact on consumer spending, lowering overall economic activity. Additionally, much beloved credit card benefits, like cash back programs or airline miles, would also be eliminated since interest income is the primary source of funding for these cardholder benefits. Besides individuals losing access to credit, small businesses would also be severely and negatively impacted by account closures. About four in five small businesses currently use credit cards in their operations, such as purchasing inventory that will be resold over the coming month. About nine in ten small businesses specifically use credit cards for financing to bridge gaps in cash flow, roughly similar to how consumers can use credit cards for consumption smoothing. About one in five of all dollars spent by small businesses are done so via a credit card. Given that the average interest rate on credit cards for small businesses is nearly the same as the average for individuals, we expect similar rates of account closures or severe credit line reductions for small business accounts as estimated for individual accounts, that is 75% to 85%.

The closure of millions of credit card accounts would also have deleterious second and third order effects. For example, the hospitality industry relies on credit card pre-authorizations (holds) as a security deposit in case of damages or additional charges like incidentals during a customer's stay. Without a credit card, hotel patrons would have to present a debit card to cover this hold, which is regularly $100 or more, and that would require having a sufficient balance in their bank account to cover the purchase. (Many hotels do not even offer this cash option but only accept credit cards.) This imposes a kind of liquidity requirement on anyone who wants to travel overnight and stay at a hotel. For higher-income earners who are more likely to have excess liquidity in their bank accounts, this is a nonissue. Conversely, for lower-income earners and those in the middle class who do not have as much excess liquidity in their bank accounts, this is a real limitation. Lower- and middle-income households would also be the cohorts disproportionately impacted by account closures following a 10% rate cap. Since roughly one-in-three Americans have $100 or less in savings, a cash deposit in lieu of a credit card hold could make a hotel stay prohibitively expensive. That, in turn, would negatively impact the hospitality industry by increasing room vacancies and reducing profitability. Even if hotel patrons can secure these cash deposits through other credit sources like payday lenders, those individuals will then have to pay interest on that borrowed money. Conversely, under current credit card arrangements, credit card users are effectively lent the money free of charge during a hotel stay. There are countless other examples, from rental cars to gasoline purchases to dining establishments, where consumers benefit from credit card companies guaranteeing funds to merchants via holds. At the time of

this writing, the advocates for a 10% rate cap have not provided any analysis to estimate the negative impacts from credit card holders losing access to this and similar services.

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